

Internal Revenue Service  
**memorandum**

CC:INTL-675-90

Br5:CMCooper

date:

FEB 6 1991

to: Matthew Wallach

from: Robert Katcher, CC:INTL:Br5 *Robert Katcher*

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subject: [REDACTED]

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This memorandum follows up our memorandum to you dated November 5, 1990, regarding the dividend transaction between [REDACTED] and its [REDACTED] subsidiary. It reflects the further discussions between our offices since your receipt of that memorandum, a copy of which is attached.

Here, we are assuming that the dividend note received by [REDACTED] from its [REDACTED] subsidiary had a fair market value that was less than originally determined. The value of the dividend note when received (and therefore its basis) is necessary to establish the amount, if any, of a claimed loss resulting from the dividend note's worthlessness.

The issue is whether the Service may establish the basis of an asset (the dividend note) acquired in a closed year in order to determine the correct amount of a loss in an open year that is attributable to the asset. The statute of limitations on assessments does not prevent the Service from challenging a return position in an open year simply because a related transaction was inaccurately reported on an earlier closed year return.

Magma Corp. v. Commissioner, 1981-2 USTC 9634 (West. Dist. Ark. 1981), holds that the Commissioner could not be estopped from challenging the basis of land which a Sub S Corporation reported on its 1971 return, and which it used in computing gain on sale of the land on its 1976 return. The statute of limitations did not prevent the Commissioner from challenging the basis the taxpayer had used in computing gain on its 1976

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return, because the Commissioner was not attempting to collect taxes for the 1971 tax year, but only attempting to ascertain the correct amount of tax due for the 1976 tax year.

The principle applied in Magma Corp., that taxable income means correct taxable income, is reflected in many decisions. See e.g., Lewis v. Reynolds, 284 U.S. 281 (1932); Springfield Street Railway v. U.S., 312 F.2d 754 (Ct. Cl. 1963); Commissioner v. Van Bergh, 209 F.2d 23 (2d Cir. 1954); Phoenix Cool Co. v. Commissioner, 231 F.2d 420 (2d Cir. 1956); State Farming Co. v. Commissioner, 40 T.C. 774 (1963); ABKCO Industries, Inc. v. Commissioner, 56 Y. C. 1083 (1971), aff'd on other grounds, 482 F.2d 150 (3rd Cir. 1973). cf., Rev. Rul. 69-543, 1969-2 C.B. 1, holding that assessments and collection of deficiencies resulting from the disallowance of the investment credit carryovers can be made even though assessment for the year in which the investment credit was incorrectly claimed is barred by 6501(a) of the Code; Rev. Rul. 74-61, 1974-1 C.B. 239, in which it was concluded that taxable income for any base period year that is barred by the statute of limitations for assessment or refund must be adjusted (where necessary) to arrive at the correct taxable income for such year in determining the base period for income averaging purposes; Rev. Rul. 56-285, 1956-1 C.B. 134, holding that the net operating loss for a taxable year, carried over and claimed as a deduction for a subsequent year, must be adjusted to reflect the amount of depreciation properly allowable for the loss year, even though the statutory period for limitation of assessment of income tax for that year has expired.

If the Service successfully reduces or eliminates the claimed loss as a result of the basis adjustment, the mitigation provisions of sections 1311 et seq. of the Code may permit the taxpayer to reopen the closed year.

We hope that the foregoing will be useful. If you have any further questions, please call Carl Cooper at FTS 566-6795.

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